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C O R R E C T E D C O P Y (TEXT PARA 2)

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EEB/IFD/OIA
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TAGS: EAGR ECIN ECON EFIN EPET ETRD EINV AJ

SUBJECT: AZERBAIJAN'S 2009 BUDGET: A SUSTAINABLE POLICY IN
AN UNCERTAIN WORLD

Classified By: Political-Economic Counselor Rob Garverick for Reasons 1
.4 (b) and (d).

¶1. (U) SUMMARY: On December 11 the Azerbaijan government (GOAJ) published the 2009 state budget, which the Milli Mejlis (Parliament) passed 92 to 8 in November. Coming from several years of strong economic growth, with increasing reserves, at the start of the global financial crisis and having limited exposure to foreign debt, Azerbaijan and its proposed 2009 budget should be able to withstand the short-term effects of the worldwide crisis, even as economic growth slows. Social programs and infrastructure dominate government spending plans. Defense spending initially shows a decline, but is likely to be revised. The GOAJ still calculates the average 2009 price of oil at \$70. Analysts over the course of the year will closely watch oil price trends, as well as inflationary pressures. Azerbaijan's non-energy sectors, always slacking, may be in for a rougher road. A reassessment of the budget mid-year is warranted to assess the long-term effects of the global crisis, decreasing oil prices (resulting in lower government revenues) and the GOAJ's ability to implement its budget plan. End Summary.

¶2. (C) After passing it through Parliament on November 25 by a vote of 92 to 8, the GOAJ published its 2009 state budget on December 11 in the state-issued government paper "Azerbaycan". Revenue is projected to be 12.12 billion AZN (15.17 billion USD), while expenditures are proposed to be 12.36 billion AZN (15.39 billion USD). The announced budget includes a deficit of over 200 million USD, less than 0.4 percent of GDP. This represents a relatively modest increase over the 2008 budget, 16 percent for revenues and 11 percent for expenditures -- at least in comparison with recent years.

(Note: Azerbaijan has adopted a policy of mid-year supplemental budget increases, so these figures are likely to change by year end. End Note.) This budget also assumes a 70 USD per barrel price for oil, the export of which makes up a significant portion of budget revenues and over 52 percent of GDP. While this assumption appears overly optimistic today, Azerbaijan's reserves, estimated at 18 billion USD should allow it to weather reduced oil prices for some time without necessitating a change in policy.

¶3. (C) The lion's share of expenditures are earmarked for

education (1.3 billion AZN), defense (1.2 billion AZN), social programs (1.1 billion AZN) and public services (975 million AZN). While President Aliyev stated during his New Year's address that defense spending would increase in 2009, this preliminary budget shows an actual decrease of 10 percent from the 2008 preliminary budget and a 25 percent decrease from the composite or supplementary budget which topped defense spending at 2 billion USD. (Note: It is likely that Aliyev was alluding to plans to increase defense spending mid-year. Post will continue to monitor this closely. End Note.)

¶4. (C) Azerbaijan heads into the next budget year in a relatively strong economic position despite the global financial crisis, double-digit inflation, and a slow-down in the growth of the oil sector due to external events and technical disruptions to offshore production. This was aided by a 15 percent growth in the non-oil sectors during the first ten months of 2008, booming oil prices until August, an expansionary fiscal policy, and an adaptive monetary policy. In fact, some financial experts suggest that the global financial slowdown is actually helping Azerbaijan in some ways by slowing or reversing the trend of high inflation. Earlier this year inflation was projected by some international monitors to reach 24 percent by year end 2008. Those same monitors now project inflation to settle at 17 percent for the year, and forecast the possibility of single digit inflation by year end 2009.

¶5. (C) International financial experts and local budget watchdogs are cautiously optimistic that the approved budget will allow Azerbaijan's economy to remain strong and relatively unscathed, despite an international downturn. A further extended decline in oil prices could impact the

budget; one source said that the GOAJ can only maintain its spending plan including the acquisition of foreign assets as long as oil trends above 54 USD per barrel. The affect of the global financial crisis on Azerbaijan's trading partners, such as Russia and Ukraine, and the recent devaluations/depreciation of the Russian rouble and Ukrainian hryvna, could also negatively impact the economy, specifically the non-oil sector. Analysts in Baku do not expect the GOAJ to devalue the national currency (Manat), which is normally pegged to a two-currency (Euros and USD) basket regime, as such an action could result in a financial panic, re-dollarization, or a run on banks. As a result, the manat, supported by Azerbaijan's national reserves, will likely remain strong.

Comment

¶6. (C) Azerbaijan's strong export revenue and current account balance, despite lower oil prices and a disruption in oil production, combined with limited exposure to foreign debt and strong currency reserves, will keep Azerbaijan's economy afloat, even as the global economy wanes in 2009. All eyes in Baku will be on global oil demand and prices, as well as inflation, all of which present a threat to budget implementation.

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